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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

No. 113

CHESTER GAINES and THERESA GAINES,
Husband and Wife,

Petitioners,

v.

GUY T. HELVERING, Commissioner of Internal
Revenue,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE PETITIONERS.

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On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

BRIEF FOR THE PETITIONERS.

Opinions Below.

The memorandum opinion of the Board of Tax Appeals (R. 15) is unreported. The opinion of the Circuit Court of Appeals is reported at 111 F. (2d) 144.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered May 8, 1940 (R. 27). The petition for writ of certiorari was filed May 29, 1940, and was granted October

14, 1940 (R. 29). The jurisdiction of this Court rests upon Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Question Presented.

Whether, under the Revenue Act of 1934, where a husband and wife living together file a joint return, the capital losses sustained by one spouse (in excess of $2,000) may be deducted from the capital gains of the other.

Statute and Regulations Involved.

The pertinent provisions of the Revenue Act of 1934 and of the regulations promulgated thereunder will be found in the Appendix, *infra*, pp. 26-30.

Statement.

The stipulated facts (R. 23-24) may be summarized as follows:

The petitioners were married and living together throughout the entire year 1934. During that year, the husband, Chester Gaines, realized a net gain (excess of his gains over his losses) from the sale of capital assets of $18,466.41, the entire amount of which was to be taken into account under Section 117(a) of the Revenue Act of 1934. The wife, Theresa Gaines, sustained a net loss (excess of her losses over her gains) from the sale of capital assets of $35,959.86, of which the amount to be taken into account under Section 117(a) of the Revenue Act of 1934 was $20,031.59 (R. 23-24).

The petitioners filed a joint income tax return for 1934. In this return, they reported a capital loss of $1,565.18,

which represented the difference between the husband's net capital gains taken into account ($18,466.41) and the wife's net capital losses taken into account ($20,031.59) (R. 24).

In auditing the return, the Commissioner held that the losses sustained by the wife could not be applied to reduce the gains realized by the husband, and that the wife's losses accordingly could be deducted only to the extent of her own gains, plus $2,000. By reason of this holding, the Commissioner added $18,031.59 to the net income reported by the petitioners (R. 24). On the basis of this adjustment, the Commissioner determined a deficiency of $5,008.55 (R. 13).

The Board of Tax Appeals sustained the Commissioner's decision (R. 16). The Circuit Court of Appeals affirmed the Board (R. 27). This Court granted certiorari (R. 29).

Specification of Errors to be Urged.

The Circuit Court of Appeals erred:

1. In holding that under the Revenue Act of 1934, a loss sustained by one spouse from the sale of capital assets is not deductible to the extent of the gain realized by the other spouse from similar sales where a joint return is filed.

2. In holding that under the Revenue Act of 1934, the excess of the losses of one spouse over his or her gains from the sale of capital assets is not deductible from the gains of the other spouse from similar sales when a joint return is filed.

Summary of Argument.

Section 51(b) of the Revenue Act of 1934 entitles a husband and wife, if they so elect, to make a single joint return, in which case their tax is to be computed "on the aggregate income." Sections 23(e) and (j) and 117(d) together provide that losses from the sale of capital assets shall be allowed as deductions only to the extent of $2,000 plus the gains from such sales.

It is the petitioners' position that when a joint return is filed, the aggregate capital losses of both spouses may be deducted to the extent of the aggregate capital gains of both spouses, without regard to whether the spouse who sustained the loss was the one who realized the gain.

1. Section 51(b), authorizing joint returns, had been uniformly construed from 1921 to 1932 as entitling married taxpayers to offset the net loss of one against the net income of the other in a joint return. Prior to 1932, the revenue laws likewise contained a section entitling taxpayers to deduct the full amount of their losses in computing net income. By virtue of this section and the accepted meaning of Section 51(b), it had become long recognized that in a joint return, the losses of one spouse could be offset against the gains (or other income) of the other spouse.

In the 1932 and 1934 Acts, Congress reenacted Section 51(b) without change. It also reenacted the section permitting the full deduction of losses in computing net income, subject only to a later section which fixed a limitation thereon. Congress thus indicated its intention to continue undiminished the pre-existing scope of the joint re-

turn privilege (including the right to pool gains and losses), except in so far as the limiting provisions, embodied in Sections 23(r)(1) of the 1932 Act and 117(d) of the 1934 Act, might specifically otherwise provide.

Sections 23(r)(1) and 117(d) are devoid of any language purporting to diminish the pre-existing marital privilege with respect to pooling gains and losses. Deduction of losses is allowed "to the extent of * * * the gains from such sales" (which is true when one spouse's losses are offset against the other's gains in a joint return); it is forbidden only if it would diminish ordinary income. Moreover, the *sole* purpose given by Congress for enacting Sections 23(r)(1) and 117(d) was to prevent capital or security losses from reducing ordinary income. This purpose is completely fulfilled if the deductibility of the losses of both spouses is limited to the gains of both spouses in a joint return.

2. All of the Circuit Court opinions upholding the Commissioner's position rest solely upon the authority of *Pierce* v. *Commissioner*, 100 F. (2d) 397 (C. C. A. 2nd), construing Section 23(r)(1) of the 1932 Act. The majority opinion there (Judge L. Hand dissented) is based upon a supposed general rule that only such amounts may be deducted in a joint return as would have been deductible had separate returns been filed. The majority opinion refers to Article 381 of Regulations 77 and judicial decisions, but it is submitted that neither authority establishes such general rule. The petitioners contend that when a deduction is limited to a specified type of income, no such general rule controls but each such deduction must be considered in the light of its separate provisions

and purposes, as outlined in the preceding paragraph hereinabove.

3. The Commissioner relies upon Articles 381 of Regulations 77 and 117-5 of Regulations 86 as establishing a binding administrative construction. As stated in Judge Hand's dissent in the *Pierce* case, Article 381 is ambiguous; despite its inclusion in the regulations since 1921, the Commissioner in December, 1932, answered the very question here involved in favor of the petitioners. As to Article 117-5, as late as February, 1936, the Commissioner was following a practice and contending for a doctrine diametrically opposed to the principle announced in that article. Moreover, Section 51(b) was not reenacted in the 1938 Act, but was changed in various respects. In any case, as was pointed out in *Janney* v. *Commissioner,* 108 F. (2d) 564, 567 (C. C. A. 3rd), the Article is unwarranted under Section 51(b) as reenacted in the 1932 and 1934 Acts.

Argument.

1. The petitioners' construction is in accord with the evident intention of Congress.

The legislative background preceding the 1932 and 1934 Acts is important. In the revenue acts prior to 1932, Congress included a provision entitling husbands and wives living together to file a single joint return, if they so elected, in which case their tax was to be computed "on the aggregate income" (Sections 223 of the 1921, 1924, and 1926 Acts, and 51(b) of the 1928 Act). As early as 1921, the Commissioner ruled that this section entitled

married taxpayers to deduct the net loss sustained by one from the net income of the other when a joint return was filed (Sol. Op. 90, 4 Cum. Bull. 236). Recognizing that an inflexible rule requiring separate returns might result in collecting taxes from a family in a year in which, regarded as a single entity, it had sustained a net loss, Congress thus conferred on husbands and wives the right "in all cases to make a joint return and have the tax computed on the combined income" (H. R. No. 350, 67th Cong., 1st Sess., p. 13).

Congress also included in the revenue laws prior to 1932 a provision which entitled taxpayers to deduct the full amount of their losses in computing net income (Sections 214(a)(5) of the 1921, 1924, and 1926 Acts, and 23(e) of the 1928 Act). By virtue of this provision and the accepted meaning of the section permitting joint returns, it had become long established by 1932, that the losses of one spouse could be offset against the gains (or other income) of the other in a joint return.

In the Revenue Acts of 1932 and 1934, Congress reenacted without change the provision with respect to the filing of joint returns (Section 51(b)).[1] Likewise, Congress reenacted the section permitting the full deduction of losses in computing net income (23(e) of the 1932 and 1934 Acts), subject only to a later section which fixed a limitation upon such deduction (23(r)(1) of the 1932 Act and 117(d) of the 1934 Act). Congress thus indicated its

[1] Congress also preserved in the 1932 and 1934 Acts the differential in favor of husbands and wives by allowing them a joint personal exemption of $2,500 while giving other individuals an exemption of $1,000 (§25(c) of 1932 Act and §25(b) of 1934 Act).

intention to continue undiminished the pre-existing scope of the joint return privilege (including the established right of pooling gains and losses), except in so far as the limiting provisions in Sections 23(r)(1) and 117(d) might specifically otherwise provide.

Sections 23(r)(1) and 117(d) are devoid of any language purporting to diminish the pre-existing marital privilege with respect to offsetting one spouse's losses against the other's gains in a joint return. Section 23 (r)(1) provides that "Losses from sales or exchanges of stocks and bonds * * * which are not capital assets (as defined in Section 101) shall be allowed only to the extent of the gains from such sales or exchanges." Section 117(d) provides: "Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges."

The deductibility of losses is thus limited in only one respect—"to the extent of the gains from such sales or exchanges". Deduction of losses is permitted if it decreases gains but not if it diminishes ordinary income. Sections 23(r)(1) and 117(d) would permit the deduction in a joint return of one spouse's losses from the other's gains "if we take words in their plain popular meaning, as they should be taken here". *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, 3.

Not only are Sections 23(r)(1) and 117(d) devoid of any language purporting to curtail the prior scope of Sections 51(b) and 23(e), but the purpose of Congress in enacting the sections was entirely foreign to any such intention. The *only* purpose given by Congress for introducing the limitation upon the deductibility of security

losses in the 1932 Act was to *prevent such losses from being offset against ordinary income.* This was expressed in the following words by both the Senate and the House Committees which drafted the 1932 Act:

> "There are no provisions in existing law corresponding to Section 23(r) (s) and (t). Many taxpayers have been completely or partially eliminating from tax their income from salaries, dividends, rents, etc., by deducting therefrom losses sustained in the stock and bond markets, with serious effect upon the revenue." (S. Rep. No. 665, 72d Cong., 1st Sess., p. 17; H. Rep. No. 708, 72d Cong., 1st Sess., p. 12.)

The same purpose was stated by the Secretary of the Treasury in his testimony before the Senate Committee in the hearings on the 1932 Act:

> "In recent years income from business profits, from salaries, and from other sources, has in many cases been offset by losses on security transactions. * * * In other words, people have been able through the taking of losses on sales of securities to wipe out any profits by way of dividends, or from business, and so forth. * * *
>
> "Now the Ways and Means Committee felt, and the Treasury agreed, that that abuse has grown to such a point that something ought to be done about it. * * * So the Treasury did agree with the Ways and Means Committee that you ought to limit the deduction of losses from the sale of securities to the amount of profits made in that same year from the sale of securities, and *that the loss resulting from*

sale of securities should not be used to wipe out other income." (Hearings before Sen. Finance Comm., 72d Cong., 1st Sess., p. 31.)

The House Subcommittee which worked upon the drafting of the 1934 Revenue Act likewise stated:

> "The Revenue Act of 1932 was enacted during a period of depression when the need for revenue was acute. It was known that the revenue from the income tax had greatly declined and a part of this decline was correctly ascribed to *the wiping out of ordinary income by the deduction therefrom of both classes of losses previously described.* The Congress therefore provided that the losses from sales of stocks and bonds held two years or less could only be taken to the extent of the gain from similar sales. *This prevented the reduction of ordinary net income from other sources by these losses.*" (Hearings before Ways and Means Comm., 73d Cong., 2d Sess., p. 46.)[2]

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[2] The same purpose that moved Congress to insert §23(r) (1) in the 1932 Act had caused Congress to introduce §208(c) into the 1924 Act (§101(b) of the 1932 Act). That section provided that capital net losses (the excess of losses over gains from sales of assets held over two years) could not decrease the tax (otherwise payable) by an amount in excess of 12½% of such capital net losses. The section was introduced into the revenue law because "the opportunity to minimize taxes by the practice of taking capital losses to offset ordinary net income constituted a particularly serious problem". *United States* v. *Pleasants,* 305 U. S. 357, 360. In fact, §23(r) (1) complemented §101(b) in the 1932 Act, for the former fixed the limitation with respect to losses from sales of non-capital stocks and bonds, while the latter fixed the limitation with respect to losses from capital assets.

This purpose of Congress, to prevent security losses from diminishing ordinary income, is fulfilled if the deductibility of security losses of both spouses is limited to the security gains of both spouses in a joint return. To permit one spouse to offset his or her security loss against the security gain of the other in a joint return would not and could not diminish the full taxability of the income of both spouses "from salaries, dividends, rents, etc."

The Commissioner's contention, however, requires the extension of the limitation prescribed in Section 23(r)(1) beyond the intention of Congress. It would not merely prevent a spouse from offsetting his or her security losses against ordinary income (which was all that Congress intended), but it would also deprive the spouse of the privilege (which had always been previously recognized under Sections 51(b) and 23(e)) of offsetting his or her secur-

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Yet the Commissioner has always recognized that under §101, the capital losses of one spouse may be offset against the capital gains of the other in a joint return. That Congress intended to make no distinction between the two sections in so far as the joint return privilege is concerned is shown by the fact that the draft of the 1932 Revenue Act adopted by the House (H. R. 10236) provided for the application of the limitation in §23(r) (1) to all securities. The Senate Committee eliminated this, stating: "The existing limitation, that capital losses cannot reduce the tax by more than 12½%, is adequate protection against excessive deductions." (S. Rep. No. 665, 72d Cong., 1st Sess., p. 10). At no time did the Committee or Congress refer to the proposed change as affecting the privilege of husband and wife to pool their gains and losses. It was apparently assumed that the privilege was the same under both §§101 and 23(r) (1).

ity losses against the other's security gains in a joint return.

With respect to the 1934 Act, the sole reason given for inserting the limitation (Section 117(d)) was the same as in the case of the 1932 Act. The House Committee explained the proposed restriction (Section 117(d)) by stating:

> "The method proposed is safe from a revenue standpoint, *inasmuch as capital losses cannot be used to reduce ordinary income* * * *." (H. Rep. No. 704, 73d Cong., 2nd Sess., p. 10.)

The House Committee which worked on the 1938 Revenue Act referred to Section 117(d) in the 1934 and 1936 Acts as follows:

> "The Committee believes that the principle adopted in the Revenue Acts of 1934 and 1936 *which denied the privilege of using capital net loss as an offset against ordinary income,* save within very narrow limits, should be adhered to at this time as a necessary and salutary safeguard of the income tax revenue." (H. Rep. No. 1860, 75th Cong., 3rd Sess., p. 37.)

Although there are additional statements declaring that the purpose in inserting Sections 23(r)(1) and 117(d) was to prevent security or capital losses from being deducted from ordinary income, nowhere in the record of the congressional committee reports or the debate on the floor of Congress is there any statement of any purpose to diminish in any way the pre-existing marital privilege of pooling gains and losses in a joint return.

2. The reasons and authorities referred to in the majority opinion in *Pierce* v. *Commissioner*, 100 F. (2d) 397 (C. C. A. 2d) do not support the decision.

All of the Circuit Court decisions upholding the Commissioner's position are based upon the precedent of *Pierce* v. *Commissioner*, 100 F. (2d) 397. There the Circuit Court of Appeals for the Second Circuit held that, under Section 23(r)(1) of the 1932 Act, the losses of one spouse from sales of securities constituting non-capital assets could not be offset against the gains of the other spouse from similiar sales in a joint return. Judge Learned Hand dissented. The same court ruled likewise in *Demuth* v. *Commissioner*, 100 F. (2d) 1012, certiorari denied, 307 U. S. 627.

The *Pierce* case was followed by the Courts of Appeals for the First and Fourth Circuits solely in deference to its prior precedent and not because of independent reasoning impelling the same conclusion.

Thus in *Nelson* v. *Commissioner*, 104 F. (2d) 521, the Court of Appeals for the Fourth Circuit indicated that a majority agreed with Judge Hand's dissent:

> "While a majority of this Court are much impressed with the reasoning of Judge Learned Hand in his dissenting opinion in the *Pierce* case, the legal question involved is a close one and we feel that we should follow the decisions of the First and Second Circuits, particularly in view of the denials of certiorari by the Supreme Court."

And in *Sweet* v. *Commissioner*, 102 F. (2d) 103, certiorari denied, 307 U. S. 627, the Court of Appeals for the First Circuit stated:

> "While the decision of the Court of Appeals for the Second Circuit may involve some doubt we do not regard it as clearly wrong and, being squarely in point, we follow it."

Likewise, in the instant case, the *per curiam* decision below of the Court of Appeals for the Second Circuit affirmed the Board upon the authority of the *Pierce* case (R. 27). And in *Taft* v. *Helvering*, 111 F. (2d) 145, No. 183 this Term, certiorari granted, October 14, 1940, the same court held *per curiam* on the authority of the *Pierce* case, that the limitation on the deduction for charities to 15% of the taxpayer's net income (Section 23(o) of the 1932 Act) must be computed with reference to the husband's and wife's separate net income, and may not be computed on their combined net income, even though a joint return is filed.

Since the *Pierce* case constituted the sole authority relied upon by all of the lower court decisions in upholding the Commissioner's position, it is important to examine the reasons and authorities referred to in the majority opinion to see whether they support the decision.

The majority opinion in the *Pierce* case holds that the regulations and decisions

> "contradict the petitioners' theory that husband and wife become a single taxable entity when they file a joint return; on the contrary each is treated as a separate individual who can carry deductions into the joint return only in his or her own right" (100 F. (2d) at 398).

The petitioners do not claim that there is any general rule that spouses filing joint returns are to be treated as

a single taxable entity; they base their case upon the considerations set forth under caption 1 hereinabove. But petitioners do contend that, contrary to the premise upon which the Court based the *Pierce* decision, there is no general rule that only such amounts may be deducted in a joint return as would have been deductible had separate returns been filed.

The majority opinion in the *Pierce* case bases this general rule not upon any provision of the revenue law, for there is none such, but upon Article 381 of Regulations 77 and judicial decisions.

Article 381 of Regulations 77 states that if a joint return is filed, "all deductions and credits to which either [spouse] is entitled shall be taken from such aggregate income." To determine the deductions to which either spouse is entitled, we must refer to the section defining the deductions to which an individual is entitled, which is Section 23 of the Revenue Act of 1932. This brings us right back to the correct meaning of Section 23(r)(1) of the 1932 Act—whether it limits the deductibility of security losses solely to the extent of requiring that their allowance should diminish security gains, or whether it extends further and abolishes the pre-existing privilege of spouses, embodied in Sections 51(b) and 23(e), to offset one's losses against the other's gains in a joint return. The answer to this question is to be found in the considerations set forth under caption 1 hereinabove. It is not supplied by referring to Article 381 (*supra*), for this merely directs us back to the original question of the correct meaning of Section 23(r)(1). As stated by Judge Hand in his dissenting opinion in the *Pierce* case, "* * *

it begs the question to say that the extent of the deduction under a separate return must be taken as a condition upon its existence" (100 F. (2d) at 398).

That the provisions of Article 381 constitute no bar to the petitioners' construction of Section 23(r)(1) is further shown by the fact that, despite their inclusion in the same form in all of the prior Treasury Regulations back to Article 401 of Regulations 62 (1921), the Commissioner on December 29, 1932, when this very question was submitted to him, expressed the opinion in a letter to the Commerce Clearing House that "The loss sustained by the husband would offset the same amount of gain realized by the wife from such source." (1933 C. C. H. Federal Tax Service, Vol. III, par. 6037). At the very least, this letter, signed by the Commissioner and bearing the symbols "RR" standing for the Rules and Regulations Section which draws up the treasury regulations, serves to indicate that the provisions of Article 381 constitute no clear statement that only such amounts may be deducted in a joint return as would have been deductible if separate returns had been filed.

Moreover, despite the inclusion of these provisions in the Regulations since 1921, the Commissioner in 1932 (*Frank B. Gummey*, 26 B. T. A. 894) and as late as 1936 (*Commissioner* v. *Brumder*, 82 F. (2d) 944 (C. C. A. 7th); *Commissioner* v. *Thomas*, 84 F. (2d) 562 (C. C. A. 5th)) was contending that the acts of husbands and wives should always be regarded as those of one person when a joint return is filed—a doctrine which goes beyond the petitioners' contention here and which would have automatically resolved the question in the instant case in favor of the petitioners.

The judicial decisions referred to in the majority opinion in the *Pierce* case likewise do not support the assumed general rule, that only such amounts may be deducted in a joint return as would have been deductible if separate returns had been filed. These cases allow one spouse to deduct in a joint return losses realized from sales to the other (*Commissioner* v. *Brumder, supra; Commissioner* v. *Thomas, supra; Hill* v. *United States*, 12 F. Supp. 798 (C. Cls.)); and to deduct losses on securities though the other spouse buys similar securities immediately thereafter (*Frank B. Gummey*, 26 B. T. A. 894). They merely recognize that the filing of a joint return does not automatically convert the transactions of husband and wife into those of one person, but the transactions continue to be given legal effect as those of separate persons. In the instant case, the acts of each spouse are recognized as producing separate legal results—the one spouse sustains losses and the other derives gains. After these acts are given their separate legal effect, the question in the instant case arises: does the limitation upon the deductibility of losses, embodied in Sections 23(r)(1) and 117(d), merely require that losses must offset gains (as petitioners contend that Congress intended) or does it go further and require that the same spouse who sustained the loss must have received the gain (as the Commissioner contends)?

Nor does the decision in *Van Vleck* v. *Commissioner*, 80 F. (2d) 217 (C. C. A. 2d), certiorari denied, 298 U. S. 656, lay down any such general rule. There the Court held that the net loss sustained by the husband in a year in which he filed a separate return might not be carried over and deducted from the income of the wife in a joint

return for the following year. The opinion relies upon the Supreme Court cases which declare that a carry-over deduction is an extraordinary right, not to be allowed unless the statute specifically so states:

> "The general principle underlying the income tax statutes ever since the adoption of the 16th Amendment has been the computation of gains and losses on the basis of an annual accounting for the transactions of the year. *Burnet* v. *Sanford & B. Co.*, 282 U. S. 359, 363, 75 L. ed. 383, 386, 51 S. Ct. 150. *A taxpayer who seeks an allowance for losses suffered in an earlier year, must be ablé to point to a specific provision of the statute permitting the deduction and must bring himself within its terms. Unless he can do this, the operations of the current year must be the measure of his burden.* * * * The points of difference between the allowances under §206(b) upon the one hand and those under §234 upon the other are important and obvious. The deductions allowable under §234 represent expenses paid or accrued or losses suffered during the same taxable year covered by the return. They are thus included in the net income according to the fundamental concept of such income reflected in the statute, instead of falling within *an exception which, irrespective of its precise extension, is a departure from the general scheme.*" (*Woolford Realty Co.* v. *Rose*, 286 U. S. 319, 326, 329.) (Italics supplied.)

It is the position of the petitioners that where deductibility is limited to the amount of a specific type of income,

no general rule controls the question whether such deduction may be offset by one spouse against the other spouse's specified type of income in a joint return. Instead, each such deduction must be considered in the light of its separate provisions and purposes, as was done in the instant case in the discussion hereinabove under caption 1. Thus, the decision in *Van Vleck* v. *Commissioner* (*supra*) rested upon the peculiar provisions and purposes of the net loss carry-over deduction, "an exception * * * which is a departure from the general scheme". There was no background of construction, as in the instant case, under which husbands and wives had been entitled for years to offset the deduction in question against the other's income in a joint return; nor was the limitation subsequently enacted, as in the instant case, with the sole purpose of remedying a particular mischief, not touching in any respect the pre-existing privilege of spouses with respect to pooling such deduction in a joint return.

The adoption of any such general rule, that the filing of a joint return may not change the amounts which would have been deductible had separate returns been filed, may have repercussions upon a number of other sections of the revenue law, in some cases to the detriment of maximum revenues:

(1) Under the net loss carry-over deduction, which was contained in the revenue acts prior to 1932 and has been reinstated in the present law (Sections 23(s) and 122 of the Internal Revenue Code), the Commissioner has heretofore contended and it has been held, that where a joint return is filed, the income of the wife must be included in computing the net loss carry-over deduction

of the husband, thereby diminishing or wiping out the carry-over deduction to which the husband would have been entitled if he had filed a separate return (*Samuel G. Adams*, 19 B. T. A. 781; *William H. Shelmerdine*, 24 B. T. A. 833).[3]

(2) In computing the net loss carry-over deduction, capital losses are deductible only to the extent of capital gains and non-business deductions only to the extent of non-business gross income (Section 122 (d)(4)(5) of the Internal Revenue Code).

(3) Section 117(e) of the Internal Revenue Code provides that a net short-term capital loss may be carried over as a deduction in the following year, but limited to "an amount not in excess of the net income" for the current year. The 1932 Act contained a similar provision (Section 23(r)(2)). Where *H* has $100,000 net short-term capital loss in 1940 and $100,000 net income, considering his transactions alone, but files a joint return reporting no net income, he would be entitled to carry over into 1941 his net short-term capital loss if there were a general rule that deductions are to be allowed as though separate returns had been filed.

[3] The same principle has been followed with respect to the consolidated returns of corporations, in cases in which the *Adams* decision *(supra)* was cited as authority. See *Kaiwiki Sugar Co.* v. *Burnet*, 63 F. (2d) 822, 824 (C. C. A. D. C.); *Crocker First Nat'l Bank of San Francisco*, 26 B. T. A. 1078, 1088.

3. The administrative construction does not support the Commissioner's position.

The Commissioner's contention with respect to the administrative construction is based upon Articles 51-1 and 117-5 of Regulations 86, promulgated under the Revenue Act of 1934.

Article 51-1 provides that when a joint return is filed, "* * * all deductions and credits to which either [spouse] is entitled shall be taken from such aggregate income". As pointed out (*supra*, p. 15), this provision is ambiguous and fails to state the answer to the question here involved; despite its inclusion in the Regulations since 1921, the Commissioner has contended in numerous cases since 1921 that the acts of husbands and wives are to be treated as those of one person when a joint return is filed, which is directly opposed to the interpretation now stated to have been expressed by this provision of the Regulations (*E. g. Frank B. Gummey*, 26 B. T. A. 894). Moreover, in December, 1932, the Commissioner answered the very question here involved in favor of the petitioners (*supra*, p. 16).

It was not until 1935, after the close of the taxable year here involved, that the Commissioner first gave notice through issuance of Article 117-5 of Regulations 86 and G. C. M. 15438, XIV-2, Cum. Bull. 156, that the earlier ruling would not be followed. Thus, taxpayers were lulled through the years 1933 and 1934 into the belief that the losses of one spouse could be offset against the gains of the other.

But even after the issuance of Article 117-5 (which specifically ruled in favor of the Commissioner as to the question at issue), the Commissioner continued to construe the law as requiring the transactions of husbands and wives to be regarded as those of one person when a joint return is filed. In February, 1936, the Commissioner filed a brief in the Fifth Circuit Court of Appeals in the case of *Commissioner* v. *Thomas,* 84 F. (2d) 562, and in the Seventh Circuit Court of Appeals in the case of *Commissioner* v. *Uihlein,* affirmed *sub nom. Commissioner* v. *Brumder,* 82 F. (2d) 944. The question involved in both cases was whether a loss sustained by one spouse from a sale made to the other was deductible in a joint return. In identical language, the Commissioner argued in both briefs as follows:

> "We submit that in providing for a 'single joint return' and a reporting of 'aggregate income', Congress intended to disregard the separate entities and to treat husband and wife, for tax purposes, as one. Their two incomes are brought together in a joint return as a unit, and their aggregate income is treated as though it were one income earned by one individual. * * * The Treasury Department at an early date so construed the statute. In I. T. 1575, II-1 Cum. Bull. 144, it was held that a joint return of husband and wife 'is one return of a taxable unit and not two returns of two units on one sheet of paper.' And in I. T. 1997, III-1 Cum. Bull. 149, *infra*, p. 18, it was held that 'such return is treated as the return of a taxable unit and the income disclosed by

the return is subject to both normal tax and surtax as though the return were that of a single individual."*

* * * * *

"The decision of the Board to the contrary is based on the previous Board decision in *Gummey* v. *Commissioner,* 26 B. T. A. 894, and was followed in the later Board decision in *Uihlein* v. *Commissioner,* 30 B. T. A. 399 (now pending on the Government's appeal to the Circuit Court of Appeals for the Seventh Circuit), and *Paul Speer* v. *Commissioner* (decided November 3, 1934, unreported), affirmed *per curiam* (C. C. A. 2nd), December 16, 1935. * * * In none of these cases did the Board answer the contentions here advanced by the Government. We submit the decisions are erroneous."

Thus in February, 1936, years after the issuance of the regulations under Section 51(b) and about a year after their issuance under Section 117(d), the Commissioner was following a practice and was urging a doctrine entirely inconsistent with that which he now states had been laid down and long continued under those regulations.

Moreover, as was pointed out in *Janney* v. *Commissioner,* 108 F. (2d) 564, 567 (C. C. A. 3rd), Section 51(b) was not reenacted in the 1938 Act, but various changes were made in the section, including a provision attach-

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*Footnote in brief: "The above rulings were made in 1923 and 1924, respectively, following the adoption of the Revenue Act of 1921. Since that time, five revenue acts have been passed without change in the provision there interpreted. The rule of implied legislative approval would seem applicable."

ing joint and several liability to married taxpayers if they filed joint returns. In *Commissioner* v. *Rabenold,* 108 F. (2d) 639, (C. C. A. 2nd), the majority opinion held that the amendment of Section 51(b) in the Revenue Act of 1938 did not constitute merely a restatement in amplified form of the pre-existing law, and denied the joint and several liability of married taxpayers under the Revenue Act of 1933, basing its decision upon the authority of *Van Vleck* v. *Commissioner, Pierce* v. *Commissioner* and *Demuth* v. *Commissioner* (*supra,* pp. 13, 17), all of which cases are relied upon by the Commissioner in the instant case.

In any case, as the Court in *Janney* v. *Commissioner, supra,* likewise stated, Article 117-5 is not a construction warranted by the words of Section 51(b) authorizing the joint return. When Congress carried forward Sections 51(b) and 23(e) into the 1932 and 1934 Acts, it preserved the full scope of the pre-existing privilege of spouses to pool their gains and losses in a joint return, and the insertion of Sections 23(r) (1) in the 1932 Act and 117(d) of the 1934 Act, which neither in language nor in purpose purported to diminish this prior privilege, constituted no justification for the issuance of a regulation which impaired the established purview of Section 51(b).

Conclusion.

For the reasons stated, it is respectfully submitted that the decision of the Court below should be reversed.

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October, 1940.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(e) *Losses by Individuals.* In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

* * * * *

(2) if incurred in any transaction entered into for profit * * *

* * * * *

(j) *Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117 (d).

* * * * *

[U. S. C., Title 26, Sec. 23.]

SEC. 51. INDIVIDUAL RETURNS.

* * * * *

(b) *Husband and Wife.*—If a husband and wife living together have an aggregate net income for the taxable year of $2,500 or over, or an aggregate gross income for such year of $5,000 or over—

(1) Each shall make such a return, or

(2) The income of each shall be included in a single joint return, in which case the tax shall be computed on the aggregate income.

* * * * *

[U. S. C., Title 26, Sec. 51.]

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

(b) *Definition of Capital Assets.*—For the purposes of this title, "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand

at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

* * * * *

(d) *Limitation on Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. If a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, sells any bond, debenture, note, or certificate or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, any loss resulting from such sale (except such portion of the loss as does not exceed the amount, if any, by which the adjusted basis of such instrument exceeds the par or face value thereof) shall not be subject to the foregoing limitation and shall not be included in determining the applicability of such limitation to other losses.

* * * * *

[U. S. C., Title 26, Sec. 101.]

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

Art. 51-1. *Individual returns.*—For each taxable year every single person and every married person not living with husband or wife for any part of the taxable year, whose gross income as defined in sections 22 and 116 is $5,000 or over, or whose net income as defined in section 21 is

$1,000 or over, must make a return of income. Every married person living with husband or wife for any part of the taxable year, but not at the close of the taxable year, must make a return if his gross income for the taxable year is $5,000 or more, or his net income is equal to, or in excess of, the credit allowed him by section 25 (b) (1) and (3) (computed without regard to his status as the head of a family). (See article 25-7.) A husband and wife living together for the entire year need make no returns unless their aggregate gross income for the taxable year is at least $5,000, or their aggregate net income is at least $2,500. If their aggregate net income for the taxable year is $2,500 or more, or their aggregate gross income is $5,000 or more, either each must make a return, or the income of each must be included in a single joint return. A husband and wife living together at the close of the taxable year but not during the entire taxable year must make a return or returns if their aggregate gross income for the taxable year is $5,000 or more, or their aggregate net income is equal to, or in excess of, the credit allowed them by section 25 (b) (1) and (3) (computed without regard to the status of either of them as the head of a family). (See article 25-7.) If the income of each is included in a single joint return, the tax is computed on the aggregate income and all deductions and credits to which either is entitled shall be taken from such aggregate income. A joint return of husband and wife may be filed only if they were living together at the close of their taxable year. If one spouse dies prior to the last day of the taxable year, the surviving spouse may not include the income of the deceased spouse in a joint return for such taxable year.

* * * * * *

Art. 117-5. ***Application of section 117 in the case of husband and wife.***—In the application of section 117, a husband and wife, regardless of whether a joint return or separate returns are made, are considered to be separate taxpayers. Accordingly, the limitation under section 117 (d) on the allowance of losses of one spouse from sales or exchanges of capital assets is in all cases to be computed without regard to gains and losses of the other spouse upon sales or exchanges of capital assets.

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